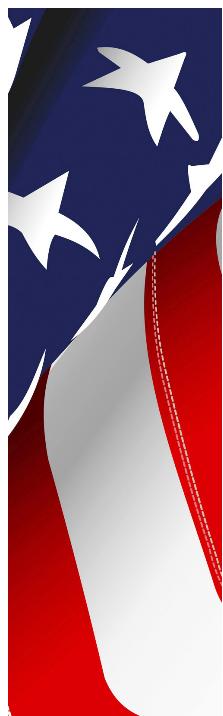
# ElectionWatch

Perspectives on the 2016 US elections from UBS CIO Wealth Management Research

24 August 2016



## After the campaigns

Following a political vetting process that spanned more than a year, we are finally getting down to "crunch time" for the 2016 US elections. Due in part to the unusually high unfavorable ratings for the two major candidates, the dynamics for this election appear quite different from those of the past. There is a fear on both sides that disaffected voters may pull the lever for a protest candidate – or perhaps even sit this election out entirely – rather than vote for what they perceive as a "lesser of two evils."

Meanwhile, the historically large pool of self-identified independent voters (42% according to Gallup) implies that the two major parties will have a smaller electoral base on which to rely and a larger portion of the electorate to win over. Much of the activity leading up to November 8th will therefore be directed toward influencing these voters in critical swing states.

But while candidates will be scrambling to woo undecided voters, investors will rightly be focused upon how best to position portfolios to prepare for what is likely to happen *after* the votes have been tallied. Although some may view this election as a simple "binary" outcome for markets (Trump vs. Clinton), we believe that the implications for the different asset classes are apt to be quite a bit more complicated.

Because while any new Administration would come in with its own set of policy priorities, the legislative agenda will still be shaped in large part by the composition of Congress. **Who controls the House and Senate – and by what margin – will therefore matter every bit as much to investors as who sits behind the desk in the Oval Office.**

So in this *ElectionWatch* report, we assess not only the likely outcome of the presidential election, but also the make-up of the legislative branch. Working with our colleagues in the UBS US Office of Public Policy, we have assigned discrete probabilities to the six plausible electoral scenarios and examined the impact of each on the legislative agenda and real economy. Finally, we focus our analysis on how the three most probable outcomes will affect each of the major US financial asset classes and sub-asset classes.

**And what we found may well surprise some people.**

While markets in general are apt to do better under a Clinton Administration, there are a number of asset classes and market sectors that would likely flourish under a Trump presidency. We also found that despite an overall market preference for Clinton, a negative scenario for markets is one in which Democrats are swept into power and take control of both the executive and legislative branches. This suggests investors would do well to remember that in this election – as with most things – the devil truly is in the details. It is with this thought in mind that we provide a detailed assessment of how each of the major asset classes will be impacted by different electoral outcomes in the pages that follow.

**Video** Mike Ryan comments on how various election outcomes might impact sectors and policy. *Click to watch.*

Contents

02 Assessing the impact
06 Legislative agenda
07 Sector implications
15 The Millennial effect
15 Publication details
16 Disclaimer

# Assessing the impact

## Elections have consequences and the composition of Congress is a critical variable

**Mike Ryan,** Chief Investment Strategist, WMA; **Tom McLoughlin**, Co-head of Fundamental Research, WMA

"It's tough to make predictions…especially about the future."
*Yogi Berra (New York Yankees Hall of Fame catcher and philosopher)*

Trying to forecast electoral results has always been something of a challenge. And despite dramatic advances in the speed and sophistication with which we gather information, the subsequent evaluation of the data remains a difficult exercise. Look no further than the recent Brexit vote in the UK for an example of the challenges inherent in predicting voter behavior. Still, as investors, it is our responsibility to give careful consideration to a range of potential political outcomes given their likely impact upon both the real economy and financial markets. So, in conjunction with our colleagues in the UBS US Office of Public Policy, we have developed our own four-step framework for assessing the investment implications for the 2016 US general election.

**Step 1**: First we assign discrete probabilities to each of six plausible electoral scenarios.

**Step 2**: We then consider the legislative agenda likely to result from these differing sets of political alignments.

**Step 3**: From here, we build upon these first two sets of assumptions to determine the macroeconomic effects (growth, inflation, and currency, as well as monetary and fiscal policy) based on each of the electoral outcomes.

**Step 4:** Finally, we utilize these legislative priorities and macro assumptions to determine the impact of each scenario upon markets at both the broader asset class and narrower sector levels. The results from this analysis are found in a table on page 7.

## Assessing the scenarios

While our overall framework incorporates each of the six plausible electoral combinations for the White House and Congress, in this report we've opted to focus on the three most probable outcomes and their likely impact on the major US financial asset classes and sectors.

These three scenarios are detailed in the table that follows.

60%
*Probability*

**SCENARIO 1**

A Clinton victory and a divided Congress

### Voting for the status quo

Both the most likely and the "best case" scenario – at least from a financial market perspective – is one in which the voters opt for divided government. Since the party that wins the White House is also likely to take control of the Senate, this scenario would entail a Clinton presidency accompanied by a very narrow Democratic majority in the Senate and a reduced Republican majority in the House of Representatives.

Despite frequent clashes over the debt ceiling, judicial appointments, and regulatory overreach, markets have become increasingly comfortable with the notion of divided government. With one party unable to unilaterally control the legislative agenda, it's more likely that the two parties will have to find some common ground on issues that engender bipartisan support, such as a modest corporate tax reform plan and incremental infrastructure spending.

*[continues next page]*

*[continued]*

Keep in mind that Hillary Clinton has a history of working with congressional Republicans as a US senator from New York. To the extent a Clinton Administration is able to reach agreement with the Republican House leadership on a narrow set of pragmatic legislative measures (which is still uncertain given the continued contentious atmosphere in DC), policy changes are likely to be incremental in scope. Markets are likely to react more favorably in that case.

This scenario would likely be seen as a modest positive for both US equity and bond markets as it preserves the status quo for many major policy stances, reduces uncertainty, and suggests only gradual rate increases. While regulatory pressures will remain high for certain sectors of the economy, we expect a modest positive market reaction as investors discount more extreme scenarios. Potential beneficiaries include transport and consumer discretionary stocks, as well as the more credit-sensitive sectors within fixed income.

25%

*Probability*

**SCENARIO 2**

A Trump victory and a Republican majority in both houses of Congress

## Trump shocks the world

Professional pundits and political veterans have dismissed Trump's candidacy from the very beginning. Yet at every stage of the process he has managed to stun the experts and exceed expectations. While the electoral math is still stacked formidably against him, were Clinton's controversies surrounding her use of a private e-mail server while Secretary of State or her affiliation with the Clinton Global Initiative to deepen, Trump could once again confound the prognosticators. If this were so, it's likely that Trump would find himself with Republican majorities in both the Senate and House – albeit rather narrow ones.

It's certainly possible that a Trump Administration could close ranks with the Republican leadership in a pragmatic move to cobble together an effective governing coalition. Were this the case, then progress could be made on a host of legislative initiatives, including a major overhaul of the tax code, increases in infrastructure spending, an easing of regulatory burdens, and a selective renegotiation of trade agreements. A more disciplined and pragmatic Trump could wind up surprising the experts yet again and deliver a more market-friendly economic and policy agenda.

However, it's not at all clear that a Trump victory could actually translate into the sort of electoral mandate that would lead to clarity on the policy front. Given the frequent clashes between the Trump campaign and party leaders, Republicans may well lack the unity necessary to govern effectively. Rather than rallying around an agreed upon core set of legislative priorities, a Trump Administration might instead expose and perhaps even deepen the fissures that currently exist between the different wings of the Republican Party.

It is this frustratingly wide range of possible outcomes that triggers such unease within the investment community. The potential for lower individual tax rates, corporate tax reform, and regulatory relief could boost near-term growth prospects. While fiscal stimulus would no doubt be welcome, the threat of trade wars, draconian changes to immigration policies, and ballooning deficits would preoccupy market participants, particularly at the onset of a Trump presidency. We would therefore expect a Trump victory to initially be received negatively by both equity and fixed income markets within the US.

8%
*Probability*

**SCENARIO 3**
Clinton victory, Democrats sweep congress

### Hillary runs the table

The boost that Clinton got coming out of the convention, coupled with Trump's erratic performance on the stump, has raised the prospects for a Democratic sweep in November.  For at least a generation, the electoral math has favored the Democrats in presidential contests. Senate contests, meanwhile, are immune from the redistricting process that follows each decennial census. And as the GOP has a greater number of incumbents standing for reelection than do the Democrats, their hold on the Senate is tenuous at best. There is now an outside shot that Democrats could take the House as well if Hillary's coattails are long enough. Were Clinton to run the table in critical swing states – and also capture a few states that traditionally vote Republican – this could provide just enough of a swing for Republicans to lose their majority in the House.

Although an admittedly low-probability event, it is our view that this also represents a negative risk case scenario from a financial market perspective. Because while a Clinton victory is likely to be viewed by market participants as preferable to a Trump triumph, the same cannot be said for a Democratic sweep of Congress. Already unnerved by the harsh populist tone taken by the Sanders and Warren wing of the Democratic Party, markets would likely react negatively if Democrats were to capture both the executive and legislative branches.

Were the legislative agenda to be pulled further to the left, both equity and bond markets would likely suffer. While a larger fiscal spending plan would likely boost economic activity, increased regulation of financials, healthcare, and the energy sector would increase policy uncertainty and dampen investor sentiment. Meanwhile, a broad-based hike in the minimum wage would pressure profit margins for industries with high-service intensity.

**Note: In a companion piece, we also summarize asset class and sector impact across the six plausible scenarios. To read, click here.**

## Limits to this analysis

There are, of course, certain limitations to this type of analysis. As we've already noted, the electorate is often fickle, which makes political events difficult to forecast – especially with such a large pool of independent and disaffected voters. So, the subjective probabilities that we've assigned to each scenario are dynamic and subject to change (we will republish refreshed probabilities in forthcoming *ElectionWatch* reports between now and the election). What's more, the policy priorities laid out during campaigns don't necessarily translate into legislative achievements. Keep in mind that former President Bill Clinton identified healthcare reform as his highest policy priority, yet his legislative legacy came to be defined instead by the NAFTA accords and a balanced budget.

But even if the legislative agenda does remain intact, the macro assumptions still may not play out precisely as expected. For example, a synchronized global recession would overwhelm any domestic political distinctions in terms of the macro impact. It's also important to keep in mind that each asset class and market sector will likewise be influenced by a host of other factors outside the Beltway. So while one candidate may be seen as a negative for the energy sector, a shock that leads to a doubling of crude prices would likely have a much greater impact on oil company shares.

## Insights and conclusions

Despite these limitations, there are several key insights and investment conclusions we have been able to draw from this analysis.

- **A Clinton presidency is generally viewed more favorably than a Trump Administration.** This appears to be based not only upon the practical experience that Clinton has gained as both a US Senator and Secretary of State, but is also related to perceptions of temperament and consistency. Given market abhorrence of uncertainty, the narrower range of potential policy and economic outcomes from a Clinton presidency is viewed more constructively.

- **There are a number of asset classes and market sectors that could actually fare better under a Trump presidency.** For example, higher interest rates and an easing of regulatory burdens under a Trump Administration would provide significant benefits to the financial sector, while fewer environmental restrictions would be a positive for fossil fuel producers. Meanwhile, a broad-based tax-cut would prompt an increase in consumer spending that provides a potential windfall for consumer discretionary stocks.

- Although a Clinton presidency is generally viewed more favorably than a Trump presidency, **we suspect that a Clinton electoral landslide leading to a Democratic sweep in Congress would be viewed negatively by markets.** The prospects for a leftward lurch in economic and regulatory policy would likely weigh upon the most cyclically sensitive sectors of the markets.

- **But even asset classes that would typically be expected to fare best under one set of outcomes could still face uncertainties.** Take municipal bonds for example. While a Democratic sweep and a corresponding increase in marginal rates would be expected to benefit municipals, a proposed cap on the municipal exemption to 28% would mute the impact.

- While defense spending is likely to expand more under a Republican leadership than under the Democrats, **we don't envision a scaling back of defense appropriations regardless of the electoral outcomes**. Given the growing threat from traditional state power players including China and Russia, the emergence of non-state entities such as ISIL, and a deepening vulnerability to cyber-attacks, leaders from both parties understand the importance of maintaining military preparedness.

- **What may come as the biggest surprise is that our overall assessment of even the worst case scenarios for this election is not more downbeat.** There has been a great deal of focus upon the unfavorable ratings of the two candidates. Yet, neither individual was ever going to be able to unilaterally impose his or her will upon the nation. Keep in mind that the checks and balances built into the US political system were intended to ensure that governing power would never be entrusted to one person or a single political institution. Even if one party is able to capture both the executive and legislative branches, there are still fail-safe provisions such as the filibuster that are intended to guard against a "tyranny of the majority." So while this election has been cast as a contest between the lesser of two evils, we believe it is instead a validation of the enduring wisdom of our Founding Fathers.

# Election impact

## Legislative agenda

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Fiscal policy** | • Middle class tax cut<br>• Limited corporate tax reform<br>• Increased public infrastructure spending | • Broad-based tax cuts<br>• Corporate tax reform<br>• Discretionary spending cuts<br>• Limited infrastructure spending<br>• Limited entitlement reform | • Middle class tax cut<br>• Increase marginal tax rates<br>• Limited corporate tax reform<br>• Closing of off-shore tax loop holes<br>• Increased public infrastructure spending |
| **Healthcare reform** | • Preserve Obamacare | • Rollback/repeal of Obamacare | • Preserve Obamacare<br>• Expand Obamacare |
| **Trade policy** | • Retain current trade agreements | • Potential repudiation of trade agreement<br>• Tariffs and import restrictions | • Retain current trade agreements |
| **Immigration** | — | • Strict enforcement of immigration laws<br>• Aggressive legal action against illegal immigrants | • Lax enforcement and/or rollback of immigration laws<br>• Path to citizenship |
| **Regulatory reform** | — | • Rollback of many Obama Administration executive orders<br>• Regulatory relief | • Increased regulation of financial, energy and healthcare sectors |
| **Gun control** | — | • Defense of 2nd amendment rights | • Assault weapons ban<br>• Stringent background checks<br>• Increased waiting period |
| **National security** | • Moderate increase in defense expenditures may have to be accompanied by some increase domestic social service spending | • Substantial increase in defense expenditures likely | • More modest increase in defense expenditures accompanied by more spending on social services |
| **Other** | — | • Build a wall | • Raise minimum wage<br>• Relief/forgiveness of student loans |

Note: In a companion piece, we also summarize this legislative table across the six plausible scenarios. To read, click here.

## Macro assumptions

Impact on a +5/-5 scale

| | SCENARIO 1: Probability 60% | SCENARIO 2: Probability 25% | SCENARIO 3: Probability 8% |
|---|---|---|---|
| GDP | +1 | +2 | +2 |
| Deficit | +1 | +3 | +2 |
| CPI | +1 | +3 | +1 |
| Fed | 0 | +2 | +1 |
| USD FX | 0 | -3 | 0 |

Each candidate's policy platform, combined with our expectations regarding the market reaction to the results of the election, leads us to certain macroeconomic assumptions. Those assumptions are set forth above for each of the three most plausible elections results. The numerical assignment indicate the anticipated magnitude of the impact of each scenario on the associated macroeconomic indicator.

# Contents

*Click on any item to go directly to the page on which it appears.*


**US equities**
**Consumer discretionary**
Autos
Durables and apparel
Media
Retail
Services
**Consumer staples**
Food, beverages and tobacco
Food and staples retailing
Household products
**Energy**
**Financial services**
Banks
Diversified financials
Insurance
Real estate
**Healthcare**
Equipment and services
Medical insurance
Pharma and biotech
**Industrials**
Defense
Transportation
Multi-industry
**Master limited partnerships**
**Technology**
Hardware
Semiconductors
Software and services
Telecommunications services
**Utilities**
**US fixed income**
Agencies
Agency mortgages
Corporate bonds
Government bonds
High-yield bonds
Municipal bonds
Preferred securites


## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **US equities** By Jeremy Zirin and David Lefkowitz | | | |
| **Overview** | **Modest positive.** We believe that this scenario preserves the "status quo" for many major policy stances (e.g. the ACA, trade) and reduces policy uncertainty. While regulatory pressures will remain high for select sectors, expect a modest positive market reaction as policy uncertainty diminishes and markets price out potentially more volatile or extreme scenarios. Prospects for greater fiscal spending on infrastructure support more balanced economic growth. | **Negative**. The potential for lower individual tax rates, corporate tax reform, and regulatory relief for financials and energy sectors would boost near-term economic growth. However, expect a significant increase in economic policy uncertainty in this scenario as real fears of trade wars and increased protectionism, sweeping changes to immigration policies, and ballooning deficits dominate the market narrative pushing equity valuations lower. | **Negative**. Increased regulation of financials, healthcare and energy increases economic policy uncertainty and puts a damper on sentiment despite the fact that a bigger fiscal spending program boosts economic growth. A hike in the minimum wage pressures profit margins for industries with high service intensity. |
| **Healthcare** By Jerry Brimeyer | | | |
| **Pharma and biotech** | **Neutral**. Clinton drug/biotech proposals to negotiate drug prices with Medicare unlikely. Other Clinton drug/biotech proposals to restrict usage of high-priced drugs are also unlikely. | **Modest negative**. Trump supports drug and biotech companies negotiating prices with Medicare, but unlikely congressional support. Other drug/biotech proposals to restrict usage of high-priced drugs are unlikely. | **Negative**. Higher likelihood of drug price limitations; limits on usage of high-priced drugs possible. Higher probability that drug and biotech companies would have to negotiate prices directly with Medicare. |
| **Medical insurance** | **Neutral**. Status quo for Obamacare, including state health exchanges and Medicaid expansion. Without the support of Congress, aid for state health exchanges and Medicaid expansion could be limited. | **Negative**. No incremental support for Obamacare. Repeal possible if Republicans have a replacement. Possible elimination of health exchanges and federal portion of Medicaid likely to become block grants, limiting Medicaid coverage. | **Positive**. Support for Obamacare, including state-exchanges and Medicaid expansion, bodes well for insurers. In general, the more Americans covered with health insurance, the better for health insurers and healthcare companies. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Equipment and services** | **Modest negative**. Status quo for Obamacare but the medical device excise tax could be reinstated in 2018. Medicare "bundled" payments for certain operations will likely lead to limitation on medical device prices. | **Modest negative**. No incremental support for Obamacare. Repeal possible if Republicans have a replacement. Two-year reprieve on medical device excise tax could be extended beyond 2018. | **Neutral**. Heavy support of Obamacare but the medical device excise tax could be reinstated in 2018. Medicare "bundled" payments for certain operations will likely lead to limitation on medical device price. |
| **Technology** By Kevin Dennean | | | |
| **Software and services** | **Modest positive** as higher GDP may drive somewhat higher corporate investment and IT spending. Corporate tax reform unlikely to have material impact on IT demand or buybacks given easy access to capital. | **Modest positive** due to positive impact on corporate investment and IT spending of higher GDP. Regulatory rollback of finance/healthcare sectors (large IT spending verticals) also positive. Corporate tax reform unlikely to have material impact on IT demand or buybacks given easy access to capital. | **Modest negative** as positive GDP impact is likely more than offset by higher offshore taxes and increased regulation in financials and healthcare verticals. |
| **Hardware** | **Neutral** as the hardware sector is dominated by a leading smartphone manufacturer. Although there is significant offshore cash across the hardware sector, corporate tax reform is likely material driver given existing easy and extremely low-cost access to capital for dividends and buybacks. | **Modest positive** as higher GDP likely has some positive impact on corporate investment and IT spending, although impact to hardware moderated by secular and deflationary shift to the cloud. Corporate tax reform unlikely to have material impact on IT demand or buybacks given easy access to capital. | **Modest negative** as positive GDP impact is likely more than offset by higher offshore taxes and increased regulation in financials and healthcare verticals. |
| **Semiconductors** | **Neutral** as semiconductor demand is driven by demand across end markets including enterprise IT (compute, storage, networking), which is unlikely to see material acceleration, and consumer electronics (primarily smartphones). | **Modest positive** as semiconductor demand is driven by demand across end markets including enterprise IT (compute, storage, networking), which would see a modest acceleration in demand, and consumer electronics (primarily smartphones). | **Modest negative** as higher tax rates and likely negative impacts on hardware and software demand across financials and healthcare verticals due to increased regulations. |
| **Telecommunication services** | **Neutral** as we believe the FCC is unlikely to allow further consolidation of US wireless industry regardless of all political scenarios with the exception of a Republican sweep (which itself would take significant time given staggered board of FCC). | **Modest positive** as expectations of further consolidation of US wireless industry under a Republican sweep would be partially offset by higher interest rate environment that would negatively impact sector valuation. Note that any change in FCC would take time given staggered board. | **Modest negative** as there would be no expectations of any further consolidation of US wireless industry regardless given Democrat sweep. Valuation negatively impacted by higher rates. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Financial services** By Brad Ball | | | |
| **Banks** | **Modest negative.** Positive GDP would be good for loan growth, but absence of rate increase would continue a margin drag. A Democratic Senate may seek a break-up of big banks but GOP House should resist and prevent significant new regulation of banks. | **Positive.** Stronger GDP and higher fed funds rate would be a positive for loan growth, margins, and credit quality. Rollback (or technical fixes) of regulations would be positive for banks. | **Negative.** Despite GDP growth and slightly higher fed funds rate, increased regulation of the financial sector would be negative for banks. Liberal wing of Democratic party may push for bank break-ups. |
| **Diversified financials** | **Modest negative.** Positive GDP would be good for loan growth, but absence of rate increase would continue a margin drag. | **Positive.** Stronger GDP and higher fed funds rate would be a positive for loan growth, margins, and credit quality. Rollback (or technical fixes) of regulations would be positive for diversified financials. More controls over (or elimination of) CFPB would be positive. | **Negative.** Despite GDP growth and slightly higher fed funds rate, increased regulation of the financial sector would be negative for banks. Mandate for increased regulation (rollback Glass-Steagall reforms, mandate for tougher CFPB, hedge fund and asset management regulations). |
| **Insurance** | **Neutral.** GDP would be good for insurance in force growth, but absence of rate increase would continue to negatively impact long-term returns. | **Neutral.** Stronger GDP and higher fed funds rate (with an upward sloping yield curve) should help investment returns. Rollback (or technical fixes) of regulations would be positive for non-bank systemically important financial institutions. Market uncertainty could drive volatility and hamper returns. | **Negative.** Despite GDP growth and slightly higher fed funds rate, increased regulation of the financial sector would be negative. Mandate for broader/stricter regulation of non-banks financials including insurance companies. |
| **Real estate**<br>By Jon Woloshin | **Neutral**. Clear benefit for housing but stricter regulatory oversight might incentivize challenges to housing and lending policies. | **Neutral**. Reduced regulation would be a positive for the housing and mortgage market. But chances of significant tax reform increase – leading to uncertainty for real estate investments – changes to mortgage interest deduction, 1031 exchanges, and the taxation of carried interest might be considered. | **Negative**. Due to increased taxes and increased deficit spending. |
| **Consumer discretionary** By Rob Samuels | | | |
| **Retail** | **Modest positive**. Middle class tax cut and raising minimum wage should be positive for consumer spending. | **Positive**. Broad-based tax cuts would be positive for consumer spending. Decline in the dollar could be a positive in addition to corporate tax reform. However, tariff and import restrictions would be a negative. | **Neutral**. Middle class tax cut and raising minimum wage should be positive for consumer spending. Increase in marginal tax rates may offset somewhat. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Media** | **Modest positive.** Middle class tax cut could be viewed as a potential positive. | **Positive**. Broad-based tax cuts a positive. Corporate tax reform may have an impact with respect to potential M&A. Decline in dollar could be positive. | **Modest negative**. Corporate tax reform and closing of tax loopholes may have an impact with respect to potential M&A. |
| **Services** | **Modest positive**. Middle class tax cut and raising minimum wage should be positive for consumer spending. | **Positive**. Broad-based tax cuts would be positive for consumer spending. Decline in the dollar could be a positive in addition to corporate tax reform. | **Neutral**. Middle class tax cut and raising minimum wage should be positive for consumer spending. Increase in marginal tax rates may offset somewhat. |
| **Durables and apparel** | **Modest positive**. Middle class tax cut and raising minimum wage should be positive for consumer spending. | **Neutral**. Broad-based tax cuts would be positive for consumer spending. Decline in the dollar could be a positive in addition to corporate tax reform. However, tariff and import restrictions would be a negative. | **Neutral**. Middle class tax cut and raising minimum wage should be positive for consumer spending. Increase in marginal tax rates may offset somewhat. |
| **Autos**<br>By Sally Dessloch | **Modest positive**. Middle class tax cut and raising minimum wage should be positive for consumer spending. | **Negative** if trade agreements are terminated or tariffs enacted; original equipment manufacturers source some vehicles sold in the US from Mexico. | **Neutral**. Middle class tax cut and raising minimum wage should be positive for consumer spending. Increase in marginal tax rates may offset somewhat. |
| Consumer staples By Sally Dessloch | | | |
| **Food, beverages and tobacco** | **Neutral**. Middle class tax cut and raising minimum wage unlikely to impact demand in a material way. | **Positive**. Could result in more lenient regulatory oversight of tobacco, food and beverage-related health and wellness issues, large-scale M&A transactions. | **Negative.** Could result in more stringent regulatory oversight of tobacco, food & beverage-related health and wellness issues, large scale M&A transactions**.** |
| **Food and staples retailing** | **Neutral**. Middle class tax cut and raising minimum wage unlikely to impact demand in a material way. | **Negative** for drug retailers if health care act is repealed and no substi-tute coverage provided. | **Modest negative** for food / drug retailers if minimum wage is increased. However, drug retail-ers could benefit from expanded healthcare coverage and price con-trols, both of which could increase demand for prescription drugs. |
| **Household products** | **Neutral**. Middle class tax cut and raising minimum wage unlikely to impact demand in a material way. | **Neutral**. Broad-based tax cuts unlikely to impact demand in a material way. | **Neutral**. Middle class tax cut unlikely to impact demand in a material way. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Energy** By Nicki Decker | | | |
| | **Modest negative** from a policy and regulatory perspective for oil and gas. Deep partisan divides on energy policy could limit significant legislative action in Congress. A more certain economic outlook under Clinton may provide a clearer path to recovery in oil prices. | **Neutral** for oil & gas. From an energy policy and regulatory perspective, this scenario would bode well for the US oil and gas industry. Coal is the largest beneficiary from executive rollbacks. However, market concerns about the impact of Trump initiatives on the US and global economy could lead to an early pullback in oil prices. | **Negative** for oil, gas, and coal. Democrats likely to promote alternative energy with funding from oil and gas industry. Fracking ban unlikely but oil and gas investors may be initially concerned that the Administration will ban or severely limit fracking. |
| **Master limited partnerships** By Jay Dobson | | | |
| | **Modest negative**. Concern should fade quickly without big regulatory push. Lower middle class tax rates could be a modest negative for tax pass-through vehicles. | **Neutral**. Positive for energy and energy infrastructure (MLP) on the margin but partially offset by larger impact of lower tax rates on tax pass-through vehicles. Increase in economic and energy demand risk offsets the balance. | **Modest negative**. Increased regulation will increase investor concerns and slow growth. Lower middle class tax rates could be a modest negative for tax pass-through vehicles, but offset by higher marginal tax rates. |
| **Utilities** By Jay Dobson | | | |
| | **Neutral**. Little incremental change from existing policy. Modest positive for renewables (wind and solar) and transmission capital spending, offset by continuing regulatory burden (certainty on Clean Power Plan) and consumer-oriented federal regulatory policies. Little impact on electricity and natural gas demand. | **Neutral**. More favorable (and less) federal regulation. Positive for existing coal infrastructure, but limited long-term benefit. Negative for renewables (wind and solar). Little impact on electricity demand; slight positive for power generation-related natural gas demand (less renewables) and related infrastructure. | **Modest negative**. Increased regulation and more consumer-oriented federal regulatory policies will increase investor concern. Modest positive for renewables (wind and solar) and transmission capital spending, offset by continuing regulatory burden (certainty on Clean Power Plan). |
| **Industrials** By David Lefkowitz and Jon Woloshin | | | |
| **Defense** | **Positive**. Clinton has expressed support for more military spending. The Republican House is concerned about the US deficit but the level of anxiety regarding the deficit is lower now than at any time in the last five years. | **Positive**. Trump supports a substantial increase in military spending. Same dynamics at work here - perceived need for a more aggressive military posture is likely to outweigh deficit concerns. | **Modest positive**. Clinton's support for more military spending but a Democratic House majority may limit size and scope of increase. |
| **Transportation** | **Modest positive**. Faster GDP growth due to fiscal stimulus should boost freight volumes. No substantial changes to trade agreements should mean that international freight volumes are unaffected in this scenario. | **Neutral**. Faster GDP growth due to fiscal stimulus should boost freight volumes. However this could be offset by higher trade barriers that reduce international freight volumes. | **Modest positive**. Faster GDP growth due to larger fiscal stimulus will boost transportation volumes. But more regulatory scrutiny and more stringent labor laws may restrain corporate profitability. More stringent environmental regulation could raise operating costs for transports. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Multi-industry** | **Neutral**. Imposition of trade barriers unlikely. Import of raw materials and export markets remain relatively unaffected. More stingent environmental regulation, if not impeded by the GOP House in some manner, could tilt the impact toward modest negative outcome. | **Modest negative**. Export markets threatened by imposition of trade barriers by the US. House GOP may resist but a Republican sweep may be seen as a mandate for action on trade. Tax reform and faster GDP growth may provide partial positive offset in this scenario. | **Modest negative**. Clinton unlikely to impose new trade barriers but Democratic House may support more labor-friendly legislation that could constrain profits. |
| **US fixed income** By Leslie Falconio | | | |
| | **Positive**. The status quo environment will keep volatility range-bound and interest rates will rise gradually – an overall positive for spread products. | **Negative**. The potential for a sharp rise in interest rates and a spike in volatility will not bode well for fixed income; neither safe havens nor risk assets. | **Modest negative**. Increased regulations on banks and balance sheet restrictions heighten potential for illiquidity in combination with the potential for higher interest rates would not bode well for fixed income. |
| **Government** By Leslie Falconio | | | |
| | **Neutral**. This would be the status quo scenario with a gradual rise in interest rates coinciding with a continuing (albeit slowly) growing economy. Interest rate volatility will remain range-bound given the unlikely disruption to current policy. Ten-year yield will progress toward the 2.0% level and foreign demand will likely remain high given the expected lower volatility. | **Negative**. A GOP sweep would likely end in a bearish steepener of interest rates. Rising deficit will result in larger Treasury auctions and supply entering the market place; while tax cuts should spur consumer spending/growth and inflation thereby steepening the yield curve. Volatility will increase substantially. | **Negative**. Interest rates rise with increasing growth and rising deficit. Volatility increases as financials underperform/completion of Dodd Frank and government-sponsored enterprise /mortgage reforms implemented – i.e., principal forgiveness. More than likely, curve will steepen even with a hawkish Fed. |
| **Agencies** By Leslie Falconio | | | |
| | **Positive**. Status quo, low volatility, Agency debt outperforms Treasury. | **Negative**. Less implicit support for government-sponsored enterprises may reduce the attractiveness of agency bonds. | **Negative**. Greater uncertainty regarding the degree of regulation and policy changes. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Agency mortgages** By Leslie Falconio | | | |
| | **Positive**. In a low volatility, range-bound environment, MBS performs well and remains the "carry" trade over Treasuries. Fed continues on its reinvestment path of principal and interest as currently implemented not anticipating an end until fed funds reach 1%. Strong environment for MBS. | **Neutral**. Negative in the short term but longer-term positive. MBS should initially underperform as the housing market begins to slow as mortgage rates increase. If growth is strong enough and the Fed hikes, then cash flow reinvestment will end and an inflow of supply will hit the market. Spreads widen, volatility increases. However, longer term, as MBS adjusts to the new rate environment, spreads should compress as the option of refinancing becomes less attractive with higher mortgage rates. If Dodd Frank is repealed, it would be a positive for MBS. Yield curve will likely steepen – also a positive for MBS longer term. | **Negative**. Affordable housing initiatives gain traction, with principal forgiveness a possibility. MBS spreads widen as banks are subject to higher regulations. Initial increase in interest rates may hurt housing market. |
| **Corporate bonds** By Barry McAlinden | | | |
| | **Positive**. Moderate growth economy and deliberate Fed limit the extent by which rates rise. Strong demand supersedes any industry-specific influences such as tighter bank regulation that affects 20% of the US IG market. | **Negative**. Strong growth, higher inflation, and a hawkish Fed lead to higher rates. Declining bond prices lead to retail outflows and weaker technicals supersede the positive risk-on environment and corporate-friendly legislation. | **Modest negative**. Stronger growth, higher inflation, and a hawkish Fed lead, higher rates and retail outflows. Tighter bank regulation (20% IG market) while good for creditors, may be too excessive. |
| **High-yield bonds** By Dan Kelsh | | | |
| | **Positive.** Modest GDP and CPI growth limits the potential for Fed rate hikes. Limited Fed action will be positive for high yield investors and support tight spreads in credit as global buyers continue to seek yield continuing the migration of investors down the ratings spectrum. | **Negative**. Political uncertainty, combined with rate hikes, to have a negative impact on high yield. US credit less appealing to global investors following the election. Rate hikes will challenge trading levels in the market. Credit spreads on existing debt widen as investors position themselves for new issues in a higher rate environment and begin migration up the ratings spectrum. | **Positive.** GDP growth drives risk-on sentiment and outpaces Fed rate hike activity. Credit spreads will remain tight as global buyers sustain their presence in US credit markets and favor improving US GDP data. |

## Asset class implications

| | SCENARIO 1: Probability 60%<br>**Clinton White House**<br>Democratic Senate majority<br>Republican House majority | SCENARIO 2: Probability 25%<br>**Trump White House**<br>Republican Senate majority<br>Republican House majority | SCENARIO 3: Probability 8%<br>**Clinton White House**<br>Democratic Senate majority<br>Democratic House majority |
|---|---|---|---|
| **Municipal bonds** By Kathleen McNamara | | | |
| | **Modest positive**. The plans to increase infrastructure spending could lead to higher municipal bond issuance. But this is more than offset by the probability that tax rates will remain where they are, which is supportive to muni prices. | **Negative**. Broad based tax cuts would reduce the value of municipal bond tax-exemption. Municipal bond mutual funds would likely experience net cash outflows causing munis to underperform US Treasury securities. Healthcare credits would underperform on the repeal of Obamacare. While the Alternative Minimum Tax (AMT) segment of the muni market would rally (based on the elimination of the AMT), it represents a smaller part of the market. | **Modest positive**. An increase in marginal tax rates would boost the appeal of tax-exempt munis leading to lower muni-to-Treasury yield ratios. But, the risk of capping the muni exemption at 28% increases and will bear monitoring. The preservation of Obamacare may cause not-for-profit healthcare credits to outperform. Revival of the taxable Build America Bonds program could increase demand from non-traditional investors. |
| **Preferred securites** By Frank Sileo | | | |
| | **Positive.** Best-case scenario for preferreds, similar to the experience of past 2½ years. Mild interest rate pressures, a Fed reluctant to raise rates too quickly, and benign credit backdrop should drive a continued hunt for yield and support the sector. | **Negative.** A rapid economic expansion would support spreads, but further tightening is limited at current levels. A sharp backup in rates (inflationary pressures, more hawkish Fed) would pressure the sector. Bank regulatory relief could provide a slight offset. | **Negative.** Economic expansion would support spreads (further tightening is limited at current levels).<br>However mild rate pressure (faster rate normalization), as well as the potential impact of increased financial regulation on bank profitability, would pressure the sector in this scenario. |

Note: UBS, as of 23 August 2016. UBS US Office of Public Policy, which is separate from UBS CIO Wealth Management Research, provided both the scenarios and the legislative agenda.

# The Millennial effect

## Mr. Trump reconsiders his position on immigration

President Barack Obama's popularity among millennials is well-known. His ability to motivate voters under the age of 32 to support his candidacy was the single biggest factor in his reelection in 2012. In crucial swing states, such as Florida, Ohio, and Virginia, he captured more than 60% of the millennial votes. Even accounting for the lower voter turnout among the younger generation, it was enough to seize the three states' corresponding 60 electoral votes.

Secretary Hillary Clinton does not enjoy the same degree of support among America's millennials, which has now surpassed the baby boomer generation as the largest voting bloc in the nation. They voted for Bernie Sanders at a ratio of more than three to one, suggesting that Clinton made little progress during the primary season convincing the youngest voters that she shares their political beliefs.[1]

Which begs the question: What do millennials believe, and how is it likely to affect this presidential election? Millennials are certainly far more diverse than older Americans. One in five has an immigrant parent. Forty percent classify themselves as non-white. And they generally hold relatively more liberal positions on civil rights, the causes of income disparity, and immigration policy than do older Americans.[2]

All of which poses a challenge for Trump in 2016 and to the GOP in future elections. According to a study by the St. Louis Fed, the share of the US population that is foreign born has risen steadily from 8.7% in 1990 to 14.2% in 2014. Half of the foreign-born population originated in Latin America, but the Asian-born population is now growing at a faster rate.[3] Trump's hardline rhetoric regarding immigration is unlikely to persuade younger voters disappointed with Clinton to register a protest vote on his behalf.

The GOP nominee's more nuanced approach toward immigration in the past few days may reflect a tacit acknowledgment that the American electorate is changing rapidly. His decision to postpone a major speech on immigration this week suggests some reconsideration. As for Clinton, she still must find a way to motivate millennials to cast a vote at all. She may be in tune with them politically, but has yet to overcome a broad generational divide.

1 Morley Winograd and Michael Hais, "The Democrats generation gap," The Brookings Institution, 3 June 2016.
2 *Ibid.*
3 Subhayu Bandyopadhyay and Rodrigo Guerrero, "Immigration Patterns in the District Differ in Some Ways from the Nation's," Federal Reserve Bank of St. Louis, April 2016.


## Publication details

**Publisher**
UBS Financial Services Inc.
Wealth Management Research
1285 Avenue of the Americas, 20th Floor
New York, NY 10019

This report was published on 24 August 2016.

**Editor in chief**
Tom McLoughlin

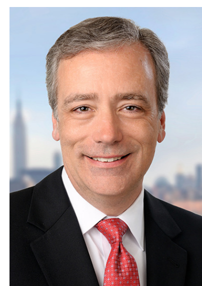
**Editor**
Roz Meyers

**Contributors**
*(in alphabetical order)*
Tom McLoughlin
Mike Ryan
John Savercool

**Acknowledgment**
We would like to thank Jake Donnenfeld, a graduate trainee at UBS, for his assistance in preparing this report.

**Project management**
Paul Leeming
Matt Siegel

**Report design**
George Stilabower

**Tom McLoughlin**

**Mike Ryan**

Leading the ElectionWatch team this year are Tom McLoughlin, Co-head of Fundamental Research, and Mike Ryan, Chief Investment Strategist, WMA.

# Disclaimer

Chief Investment Office (CIO) Wealth Management (WM) Research is published by UBS Wealth Management and UBS Wealth Management Americas, Business Divisions of UBS AG (UBS) or an affiliate thereof. CIO WM Research reports published outside the US are branded as Chief Investment Office WM. In certain countries UBS AG is referred to as UBS SA. This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. We recommend that you obtain financial and/or tax advice as to the implications (including tax) of investing in the manner described or in any of the products mentioned herein. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS and its affiliates). All information and opinions as well as any prices indicated are current only as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS AG, its affiliates, subsidiaries and employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. This report is for distribution only under such circumstances as may be permitted by applicable law.

Distributed to US persons by UBS Financial Services Inc. or UBS Securities LLC, subsidiaries of UBS AG. UBS Switzerland AG, UBS Deutschland AG, UBS Bank, S.A., UBS Brasil Administradora de Valores Mobiliarios Ltda, UBS Asesores Mexico, S.A. de C.V., UBS Securities Japan Co., Ltd, UBS Wealth Management Israel Ltd and UBS Menkul Degerler AS are affiliates of UBS AG. UBS Financial Services Incorporated of PuertoRico is a subsidiary of UBS Financial Services Inc. UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. The contents of this report have not been and will not be approved by any securities or investment authority in the United States or elsewhere. UBS Financial Services Inc. is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule.

UBS specifically prohibits the redistribution or reproduction of this material in whole or in part without the prior written permission of UBS and UBS accepts no liability whatsoever for the actions of third parties in this respect.

Version as per September 2015.

© UBS 2016. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.